

DEPARTMENT OF STATE REVENUE

04-20170603.LOF

Letter of Findings Number: 04-20170603
Use Tax
For Tax Years 2013-15

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Business provided substantial documentation supporting its position that some shipping materials were used in a non-returnable manner. Those materials qualified for the non-returnable shipping materials exemption.

ISSUE**I. Use Tax–Non-returnable shipping materials.**

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-9; IC § 6-8.1-5-1; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Brambles Industries, Inc., d/b/a Chep USA v. Ind. Dept. of Revenue*, 892 N.E.2d 1287 (Ind. Tax 2008); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-16](#).

Taxpayer protests the imposition of use tax on shipping materials.

STATEMENT OF FACTS

Taxpayer is a manufacturer in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had purchased some tangible personal property ("TPP") during the tax years 2013, 2014, and 2015 ("Tax Years") without paying sales tax at the time of the purchase. The Department therefore issued proposed assessments for use tax, penalties, and interest for those years. Taxpayer protested a portion of the proposed assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Non-returnable shipping materials.**DISCUSSION**

Taxpayer protests the imposition of use tax on its purchase of TPP which it claims was used as non-returnable shipping materials. In the course of the audit, the Department determined that the materials in question were either pre-made returnable pallets or consisted of wood, nails, and staples used by Taxpayer to construct returnable pallets. There is an exemption for non-returnable shipping materials, but there is no exemption for returnable shipping materials. The Department considered all of Taxpayer's purchases from a particular vendor ("Vendor") to constitute returnable shipping materials and so included all purchases from Vendor in its calculations of use tax due on taxable purchases. Due to the large number of purchases Taxpayer made during the audit period, the Department and Taxpayer agreed to take a random sample of those purchases and review them for sales and use tax compliance. Total purchases were used as the denominator and sales or use tax properly paid was used as the numerator. The resulting percentage was used as Taxpayer's compliance rate and that rate was applied to Taxpayer's total purchases for the tax years. Taxpayer agrees with the method, but protests that some items listed as taxable but without tax paid were actually exempt purchases and so should not be in the numerator of the calculation. Taxpayer protests that only some of the pallets it purchased or constructed from materials purchased from Vendor were returnable while many pallets were not returned by its customers thereby making the purchase of materials for those pallets eligible for the exemption.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's

claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[w]hen [courts] examine a statute that an agency is 'charged with enforcing. . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Sales tax is imposed by IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Use tax is imposed by IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction.

Next, IC § 6-2.5-5-9 provides:

- (a) As used in this section, "returnable containers" means containers customarily returned by the buyer of the contents for reuse as containers.
 - (b) Sales of returnable containers are exempt from the state gross retail tax if the transaction constitutes selling at retail as defined in [IC 6-2.5-4-1](#) and if the returnable containers contain contents.
 - (c) Sales of returnable containers are exempt from the state gross retail tax if the containers are transferred empty for the purpose of refilling.
 - (d) *Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for:*
 - (1) *selling the contents that the person adds; or*
 - (2) *shipping or delivering tangible personal property that:*
 - (A) *is owned by another person;*
 - (B) *is processed or serviced for the owner; and*
 - (C) *will be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in the owner's business of manufacturing, assembling, constructing, refining, or processing.*
- (Emphasis added).*

Also, [45 IAC 2.2-5-16](#) states:

- (a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.
- (b) In general the gross proceeds from the sale of tangible personal property in a transaction of a retail merchant constituting selling at retail are taxable. This regulation [[45 IAC 2.2](#)] provided an exemption for wrapping materials and containers.
- (c) General rule. *The receipt from a sale by a retail merchant of the following types of tangible personal*

property are exempt from state gross retail tax:

- (1) Nonreturnable containers and wrapping materials including steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property.
- (2) Deposits for returnable containers received as an incident to a transaction of a retail merchant constituting selling at retail.
- (3) Returnable containers sold empty for refilling.
- (d) Application of general rule.
 - (1) Nonreturnable wrapping material and empty containers. To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way:
 - (A) The purchaser must add contents to the containers purchased; and
 - (B) The purchaser must sell the contents added.
 - (2) Returnable containers sold at retail with contents. To qualify for this exemption, the returnable containers must be:
 - (A) Sold in a taxable transaction of a retail merchant constituting selling at retail; and
 - (B) Billed as a separate charge by the retail merchant to his customer. If there is a separate charge for such containers, the sale of the container is exempt from tax under this regulation [\[45 IAC 2.2\]](#).
 - (3) Returnable containers sold empty. To qualify for this exemption the returnable container must be resold with the purpose of refilling. The sale of returnable containers to the original or first user thereof is taxable.
- (e) Definitions.
 - (1) Returnable containers. As used in this regulation [\[45 IAC 2.2\]](#), the term returnable container means containers customarily returned by the buyer of the contents for reuse as containers.
 - (2) Nonreturnable containers. As used in this regulation [\[45 IAC 2.2\]](#), the term "nonreturnable containers" means all containers which are not returnable containers.

(Emphasis added).

The Department considered that the TPP purchased from Vendor were used as returnable pallets or were used to construct returnable pallets and so the exemption described by [45 IAC 2.2-5-16](#) was not available to Taxpayer.

Taxpayer argues that a portion of the TPP it purchased from Vendor to construct shipping pallets qualifies for the exemption discussed in [45 IAC 2.2-5-16](#). Specifically, Taxpayer states that all of the pallets it constructed for export shipments of its product were non-returnable. Also, Taxpayer states that only those pallets it purchased or constructed for shipment of its product to ten of its largest customers were returned. All other pallets it purchased or constructed from the TPP it purchased from Vendor were not returned.

Of relevance is the Indiana Tax Court's decision in *Brambles Industries, Inc., d/b/a Chep USA v. Ind. Dept. of Revenue*, 892 N.E.2d 1287 (Ind. Tax 2008), in which the court provided:

The manufacturers also claim that their lease payments are exempt from sales tax pursuant to Indiana Code § 6-2.5-5-9, which exempts "[s]ales of ... empty containers ... if the person acquiring the ... containers acquires them for use as nonreturnable packages for selling the contents that he adds." IND. CODE ANN. § 6-2.5-5-9(d) (West 2001). See also 45 IND. ADMIN. CODE 2.2-5-16(a) (2001). The manufacturers claim that the pallets are nonreturnable containers because the retailers do not return the pallets to them. (See Pet'r Br. at 16, 18.) The Department, on the other hand, argues that the pallets are returnable containers because the pallets are returned, albeit to Chep. (See Resp't Br. at 14.) Thus, the resolution of the issue hinges on to whom the pallets must be returned.

Nonreturnable containers are defined as "containers which are not returnable containers." 45 I.A.C. 2.2-5-16(e)(2). Returnable containers are defined as "containers customarily returned by the buyer of the contents for reuse as containers." A.I.C. § 6-2.5-5-9(a); 45 I.A.C. 2-5-16(e)(1). To the extent that the statute and regulation do not define the word "return" the Court will give it its plain, ordinary, and usual meaning, as defined in the dictionary. See *Johnson County Farm Bureau Coop. Ass'n v. Indiana Dep't of State Revenue*, 568 N.E.2d 578, 580-81 (Ind. Tax Ct.1991), *aff'd* by 585 N.E.2d 1336 (Ind.1992). "Return" is defined as "to pass back to an earlier possessor" and "to bring, send, or put (a person or thing) back to or in a former position." WEBSTER'S THIRD NEW INT'L DICTIONARY 1941 (2002 ed.).

Neither the statute, the regulation, nor the dictionary definition of the word "return" require that the container go back to the person from whom it was immediately acquired in order to be considered "returned," as the manufacturers contend. **It is enough that the pallets are "pass[ed] back to an earlier possessor," which in this case is Chep. *Id.* Consequently, the Court concludes the pallets are returnable containers and therefore the manufacturers' lease payments do not qualify for the nonreturnable container exemption.**

Id. at 1290-91.
(**Emphasis added**).

Taxpayer provided substantial documentation and calculations to support its protest. Taxpayer also provided substantial documentation regarding the pallets and boxes which it agreed were taxable as returnable shipping materials. The remaining amount of purchases from Vendor, Taxpayer argues, were for non-returnable shipping materials which did qualify for the exemption.

After review, the Department agrees with Taxpayer's protest regarding the materials designated as non-returnable. In support of its position that the export pallets are not returned and that a percentage of pre-made and constructed pallets are not returned, Taxpayer has provided substantial documentation, including but not limited to: purchase invoices for the TPP from Vendor, shipping pallet options for its customers, expense account spreadsheets for the larger customers who do return the pallets, and export shipping information. Regarding the pre-made returnable pallets and wood, nails, and staples used by Taxpayer to construct returnable pallets, which Taxpayer purchased from Vendor, the Department agrees with Taxpayer's protest. Taxpayer acknowledged that certain portions of that TPP were returned, but also that the remaining amounts were not returned. Following the court's explanation in *Brambles*, for pallets to be considered returnable, "It is enough that the pallets are 'pass[ed] back to an earlier possessor,'" . In the instant case, since some pre-made and constructed pallets are returned and some are not, Taxpayer is correct that some TPP it purchased from Vendor qualified for the exemption provided by IC § 6-2.5-5-9(d).

In conclusion, Taxpayer is sustained on its protest of the Department's inclusion of TPP purchased from Vendor which was either pre-made pallets or wood, nails, and staples used to create pallets which were non-returnable shipping materials. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong. The Department will remove these purchases from its calculations of Taxpayer's use tax compliance rate and will recalculate that rate. The Department will then apply the revised compliance rate to Taxpayer's total purchases to arrive at revised assessments of use tax due for the Tax Years.

FINDING

Taxpayer's protest is sustained.

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An [html](#) version of this document.